SENATE TAXATION
EXHIBIT NO. 7
DATE 1.18.11
BILL NO. SB70

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

# Fiscal Note 2009 Biennium

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| Bill # | HB0644 (2007 session) | Title: | Revise net operating loss to conform to federal law |
| Primary Sponsor: | Sonju, Jon | Status: | As Introduced |

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☐ Technical Concerns
- ☑ Included in the Executive Budget
- ☑ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

## FISCAL SUMMARY

| | FY 2008 Difference | FY 2009 Difference | FY 2010 Difference | FY 2011 Difference |
|---|---|---|---|---|
| **Revenue:** | | | | |
| General Fund | ($100,000) | ($200,000) | ($200,000) | ($200,000) |
| **Net Impact-General Fund Balance** | ($100,000) | ($200,000) | ($200,000) | ($200,000) |

**Description of fiscal impact:**
This bill would tie Montana's provisions for carrying corporations' net operating losses back and forward to federal law, which generally allows losses to be carried back fewer years, but to be carried forward for more years. This would reduce general fund revenue by up several million dollars per year beginning in FY 2016. This bill also would allow corporations that acquire another company to carry losses from before the merger forward. This would reduce general fund revenue by about $200,000 per year.

## FISCAL ANALYSIS

**Assumptions:**

1. A corporation with a net operating loss in one tax year can carry that loss backward or forward to offset income in other tax years and reduce its taxes in those years. Under current law section, 15-31-119, MCA, a net operating loss must first be carried back to the three previous tax years; if it is more than net income for those years, it can be carried forward for up to seven years.
2. Beginning with tax year 2007, this bill would tie carry-backs and carry-forwards to the provisions of Section 172 of the Internal Revenue Code. In most cases, federal law allows net operating losses to be carried back for two years and carried forward for twenty years, though there are several exceptions.
3. The change from three-year to two-year carry-back would affect tax payments from corporations with losses in the current tax year, losses in the two previous tax years, and net income in the year before that. Any corporations in this position would be required to carry their current losses forward instead of back for three years. This would reduce current refunds to such corporations and reduce future collections from

them. These changes are expected to be minor, and there may be no corporations in this position, so no revenue effect is estimated from this change.

4. The change from seven-year to twenty-year carry-forward will allow corporations that are unable to use all of their net operating loss carry-forwards within seven years to carry them forward and use them in the eighth through twentieth years. This will first affect revenue when net operating losses from tax year 2007 are carried forward to returns for tax year 2015 which will be filed in FY 2016 or FY 2017.
5. Under current law, when corporations merge, the merged corporation is not allowed to deduct net operating losses incurred by the corporations that were merged. This bill would allow the acquiring corporation to deduct its net operating losses but not those of the acquired corporation.
6. On average, the Department of Revenue collects about $200,000 per year from adjustments made to returns of corporations that have claimed deductions for net operating losses carried over from before a merger. Additional corporations file correctly and do not claim losses carried over from before a merger. Thus, the impact of allowing the purchasing corporation to deduct its losses carried forward from before the merger is estimated to be $200,000 per year. This will first affect revenue on returns for tax year 2007, which will be filed beginning in the spring of FY 2008. General fund revenue will be reduced by $100,000 in FY 2008 and by $200,000 per year beginning in FY 2009.
7. This bill would not significantly affect the Department of Revenue's costs of administering the corporation license tax through FY 2011.

| **Fiscal Impact:** | **FY 2008 Difference** | **FY 2009 Difference** | **FY 2010 Difference** | **FY 2011 Difference** |
|---|---|---|---|---|
| **Revenues:** | | | | |
| General Fund (01) | ($100,000) | ($200,000) | ($200,000) | ($200,000) |
| **TOTAL Revenues** | ($100,000) | ($200,000) | ($200,000) | ($200,000) |
| **Net Impact to Fund Balance (Revenue minus Funding of Expenditures):** | | | | |
| General Fund (01) | ($100,000) | ($200,000) | ($200,000) | ($200,000) |

**Effect on County or Other Local Revenues or Expenditures:**

1. None.

**Long-Range Impacts:**

1. Allowing corporations to carry net operating losses forward for twenty years will reduce general fund revenue beginning in FY 2016. The amount of reduction will vary significantly from year to year depending on whether corporations with losses carried forward for more than seven years have income to offset in the eight through twentith year. Revenue losses may be up to several million dollars in some years.
2. There may be an interaction between the longer carry-forward period in this bill and allowing losses to be carried forward through a merger. In a case where a merged corporation has larger net operating loss carry-forwards than it could use in seven years, it would be able eventually to deduct more of those losses than under current law.
3. The Department of Revenue will need to track and verify companies' net operating loss carry-forwards for twenty years rather than seven. This will require retaining data for an additional 13 years and will require the department to keep data from previous data processing systems. This is expected to cost about $2,000 per year.

**Technical Notes:**

1. Under federal net operating loss rules, it is possible for a company to have multiple carry-over provisions applying to different losses.
2. Tying the state's carry-over period to federal law makes any federal changes, including temporary ones such as the ones Congress enacted retroactively for two years in 2002, applicable to the state.

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| *Sponsor's Initials* | *Date* | *Budget Director's Initials* | *Date* |